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IN THE

**SUPREME COURT OF THE UNITED STATES**

OCTOBER TERM, 1939

No. 1044

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THE UNION TRUST COMPANY OF INDIANAPOLIS,  
as Former Executor of the Last Will and Testament of  
William H. Block, Deceased,

*Petitioner and Appellant, below,*

*v.*

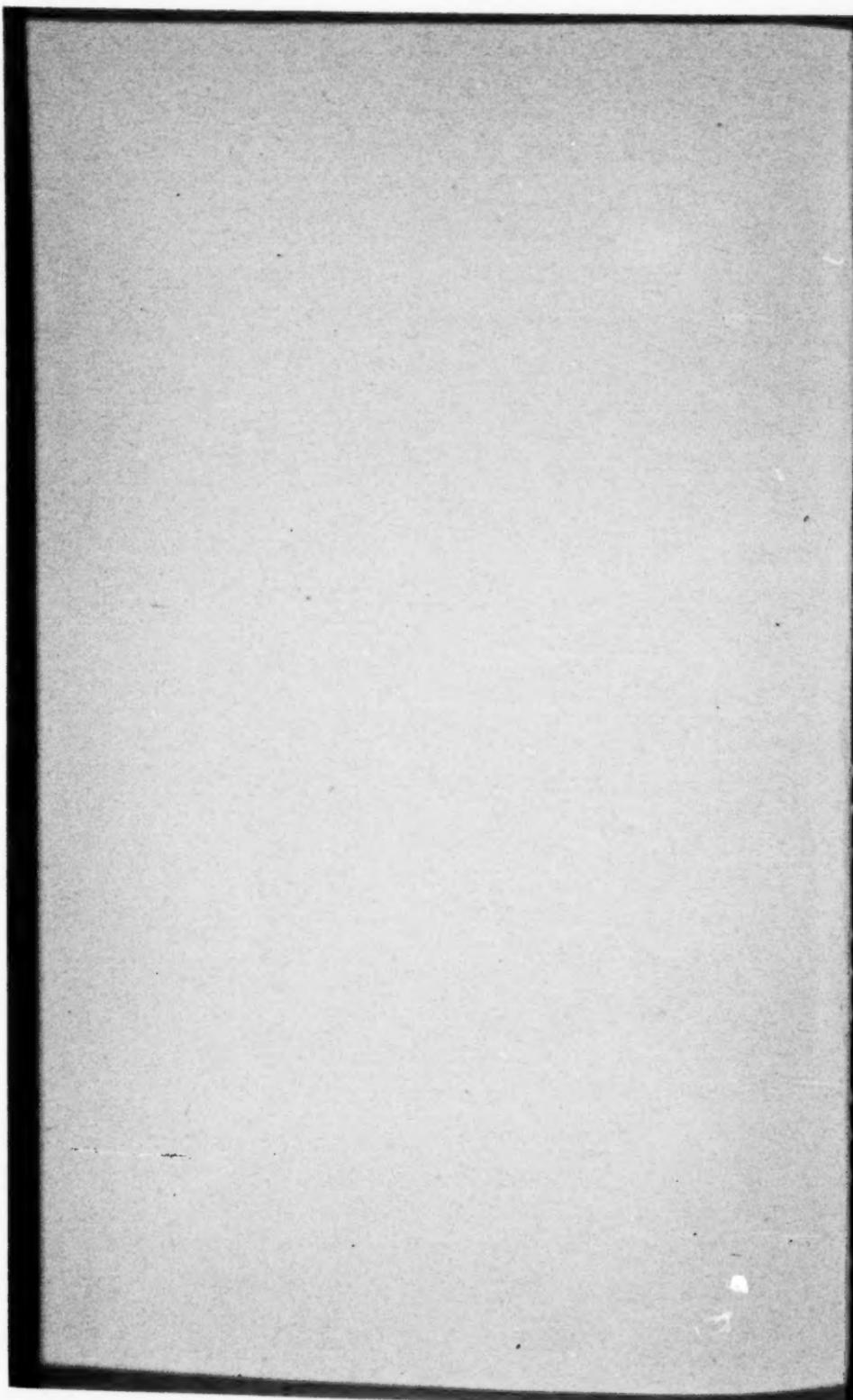
COMMISSIONER OF INTERNAL REVENUE,  
*Respondent and Appellee below.*

**PETITION FOR WRIT OF CERTIORARI.**  
With Supporting Brief.

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*Counsel for Petitioner.*

ERNEST R. BALTZELL,  
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GUSTAV H. DONGUS,

*Of Counsel.*



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IN THE  
**SUPREME COURT OF THE UNITED STATES**

OCTOBER TERM, 1939

No. \_\_\_\_\_.

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THE UNION TRUST COMPANY OF INDIANAPOLIS,  
as Former Executor of the Last Will and Testament of  
William H. Block, Deceased,

*Petitioner and Appellant, below,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent and Appellee below.*

---

**PETITION FOR WRIT OF CERTIORARI.**

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May it Please the Court:

The petitioner, The Union Trust Company of Indianapolis as former Executor of the Last Will and Testament of William H. Block, deceased, respectfully presents that:

I.

**SUMMARY STATEMENT OF THE MATTER  
INVOLVED.**

This petition seeks review of a judgment of the Circuit Court of Appeals for the Seventh Circuit, which affirmed

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a judgment of the Board of Tax Appeals, confirming a deficiency assessment of income tax against petitioner for the calendar year 1932, in the amount of \$49,797.74, involving two separate and distinct controverted items.

*First.* The Commissioner included in petitioner's income for the calendar year 1932 a refund of \$603,983.25 federal estate tax received in that year as a consequence of additional credits for state estate tax imposed by a retroactive state law enacted in the year 1931, whereby the state took advantage of the additional 80% credit for state taxes granted by the Revenue Act of 1926. The effect of the retroactive tax imposed by the Indiana law of 1931 was merely to divert to the State of Indiana amounts previously paid as estate tax to the United States. While these amounts had been paid in the years 1930, 1931, and 1932, and deducted from petitioner's taxable income returned in those years, the fact that such refund would be made was known to the responsible taxing officials almost two and one-half months before limitations had barred a deficiency assessment on petitioner's return for the calendar year 1929, and such refund was actually received October 12, 1932, when there yet remained more than seventeen months to reassess petitioner's income tax liability for the year 1931, and more than five months to reassess the tax of 1930.

Petitioner contends that this refund was not in law income, that it could only be taxable as such by reason of some equitable estoppel arising from its prior deduction in computing taxable income; and since the impropriety of the previous deductions was discovered in ample time to have redetermined the liability for the prior years, it was not properly taxable as income in the year received.

*Second.* The Commissioner disallowed as deduction from petitioner's taxable income for the year 1932 \$105,583.34 actually paid from income, and by the will of the testator directed to be paid annually from income, to various beneficiaries of the estate, upon what petitioner contends to be a mistaken application of the rule of *Burnet v. Whitehouse*, 283 U. S. 148, and *Helvering v. Pardee*, 290 U. S. 365, 370. The Court concluded (we submit erroneously) that a direction in the will that any deficiency of income should be supplied by a pledge of corpus to be defrayed from future income, made the gifts payable at all events and from corpus, rendering applicable the rule of the case last cited rather than that of *Irwin v. Gavit*, 268 U. S. 161, which petitioner submits is applicable.

The opinion is found on pages 110 to 114 of the record, and is reported — Fed. (2d) —.

## II.

### JURISDICTION TO REVIEW THE JUDGMENT.

This Court has jurisdiction to review by virtue of Internal Revenue Code, Section 1141 (a), 26 U. S. C. A., Section 1141 (a) and Section 240 (a) of the Judicial Code, as amended. (28 U. S. C. A. s. 347, (a) ). This petition, the annexed brief, and the record have been filed within the time prescribed by the Act of February 13, 1925, c. 229, s. 8, 43 Stat. 940, 28 U. S. C. A. s. 350, since the judgment of the Circuit Court of Appeals for the Seventh Circuit was entered February 27, 1940 (R. 115). No petition for a rehearing was filed.

## III.

## QUESTIONS PRESENTED.

1. Whether, under the Sixteenth Amendment and the Revenue Act of 1932, a refund of federal estate tax to an executor was taxable income in the year received.
2. Whether, under the Sixteenth Amendment and the Revenue Act of 1932, a refund of federal estate tax to an executor was taxable income in the year received merely by reason of the fact that the tax refunded had been taken as an allowable deduction from taxable income of prior years.
3. Whether, under the Sixteenth Amendment and the Revenue Act of 1932, a refund of federal estate tax to an executor was taxable income in the year received merely by reason of the fact that the tax refunded had been taken as an allowable deduction from taxable income of prior years, when the certainty of such refund was known to the Bureau of Internal Revenue in ample time to have re-determined the taxpayer's liability for all such prior years, and such refund was actually paid and received five months and seventeen months, respectively, before limitations had run on reassessment of the taxpayer's liability for two of such prior years.
4. Whether, under Section 22(b)3 and 162(b) of the Revenue Act of 1932, petitioner was taxable as a fiduciary upon income periodically paid to beneficiaries under express testamentary direction to make such payments from income, merely because the executor was directed to supply a deficiency of income by borrowing upon pledge of the corpus, which pledge was also directed to be discharged from future income.

## IV.

REASONS RELIED ON FOR THE ALLOWANCE OF  
THE WRIT.

1. In holding that the refund of federal estate tax was *per se* taxable income in the year received, the Circuit Court of Appeals for the Seventh Circuit erroneously decided an important question of federal law which has not been but should be settled by this Court, in that the refund of an estate tax does not, without more, constitute income within the meaning of the Sixteenth Amendment and the Revenue Act of 1932.

2. In holding that the refund of federal estate tax was *per se* taxable income in the year received, the Circuit Court of Appeals for the Seventh Circuit erroneously interpreted and misapplied the decision of this Court in *Burnett v. Sanford and Brooks Co.*, 282 U. S. 359, in that the tax in question in the latter case had, as an expense of operations, operated to reduce actual net income in the year paid, and its refund amounted to the deferred receipt of income, whereas the tax in question in the instant case was a capital levy, which bore no relation to the earning of income, and constituted a restoration of capital when refunded.

3. In holding that petitioner's tax liability on account of the refunded federal estate tax should be adjusted by treating the refund as income in the year refunded, rather than by redetermining liability upon the returns of prior years in which the amount of the tax had been deducted from taxable income, the Circuit Court of Appeals has rendered a decision in conflict with the decisions of the Circuit Court of Appeals for the Fourth Circuit in *Inland Products Co. v. Blair*, (C. C. A. 4th, 1929), 31 F. (2d) 867,

and *Leach v. Commissioner of Internal Revenue*, (C. C. A. 1st, 1931), 50 F. (2d) 371.

4. In holding that the refund of federal estate tax was taxable to petitioner in the year received, because the refunded estate tax had been deducted from taxable income in the years in which paid and because "it is now too late to revise the returns for those years and to require the petitioner to pay the tax which would have been required of it except for the wrongful deductions," and in ignoring the fact that when the refund was made it was *not too late* "to revise" two of the prior returns, and that the Bureau knew of the impending refund in time to have revised all of the prior returns, the Circuit Court of Appeals for the Seventh Circuit has decided (we submit erroneously) an important question of federal law which has not been but should be settled by this Court.

5. In holding that the refund of federal estate tax was taxable to petitioner in the year received, because the refunded estate tax had been deducted from taxable income in the years in which paid and because "it is now too late to revise the returns for those years and to require the petitioner to pay the tax which would have been required of it except for the wrongful deductions," and in ignoring the fact that *when the refund was made* it was *not too late* "to revise" two of the prior returns, and that the Bureau knew of the impending refund in time to have revised all of the prior returns, the Circuit Court of Appeals for the Seventh Circuit has in effect decided that such circumstances estop the taxpayer to deny the taxability as income of items not otherwise taxable as such because of benefits received in prior years, in probable conflict with the decision of this Court in *McEachern v. Rose*, 302 U. S. 56.

6. In holding that bequests of income to be paid annually, which were actually paid from income, were not deductible from petitioner's fiduciary return of income under Section 162(b) of the Revenue Act of 1932, because of the direction to make up deficiency of income by loans upon pledge of the corpus of the estate to be discharged from future income, the Circuit Court of Appeals has decided a question of federal law in probable conflict with the decision of this Court in *Irwin v. Gavit*, 268 U. S. 161.

7. The decision of the Circuit Court of Appeals is in probable conflict with *Irwin v. Gavit*, 268 U. S. 161, in that the testamentary direction to supply deficiency of income by pledge of the corpus to be discharged from future income did not change the bequests of income into bequests payable at all events, since the receipt by the beneficiary of other than income was conditioned not only upon ability to borrow but also upon there being a reasonable probability of future income sufficient to discharge the pledge, hence payments of income were properly deductible under Section 162(b) of the Revenue Act of 1932.

8. The Circuit Court of Appeals has erroneously decided an important question of federal law as to the application of Sections 162(b) and 22(b)(3) of the Revenue Act of 1932 which has not been but should be settled by this Court, in that it has held that a bequest of income only, followed by a direction to supply any deficiency of income by pledge of the corpus to be discharged from future income, constitutes a single bequest payable at all events so that payments of *income* made pursuant thereto are not deductible from fiduciary returns of income under Section 162(b) of the Revenue Act of 1932.

9. If the non-deductibility of income payments made to the income beneficiaries of the testator is deemed to

be concluded by the decisions in *Burnet v. Whitehouse*, 283 U. S. 148, and *Helvering v. Pardee*, 290 U. S. 365, 370, petitioner respectfully submits that the rule of those cases should be modified to exclude the instant case, where bequests payable and paid from income only are supplemented with a further bequest, not of corpus or proceeds thereof, but of money to be obtained by loans payable only from future income.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. 7034, and entitled, "The Union Trust Company of Indianapolis, as Former Executor of the Last Will and Testament of William H. Block, Deceased, Petitioner, v. Commissioner of Internal Revenue, Respondent," and that the judgment of the United States Circuit Court of Appeals for the Seventh Circuit in said case may be reversed by this Court, and that your petitioner may have such other and further relief in the premises as to this Court may seem meet and just; and your petitioner will ever pray.

THE UNION TRUST COMPANY OF  
INDIANAPOLIS

As Former Executor of the Last Will and  
Testament of William H. Block, Deceased,

By PAUL Y. DAVIS,

KURT F. PANTZER,

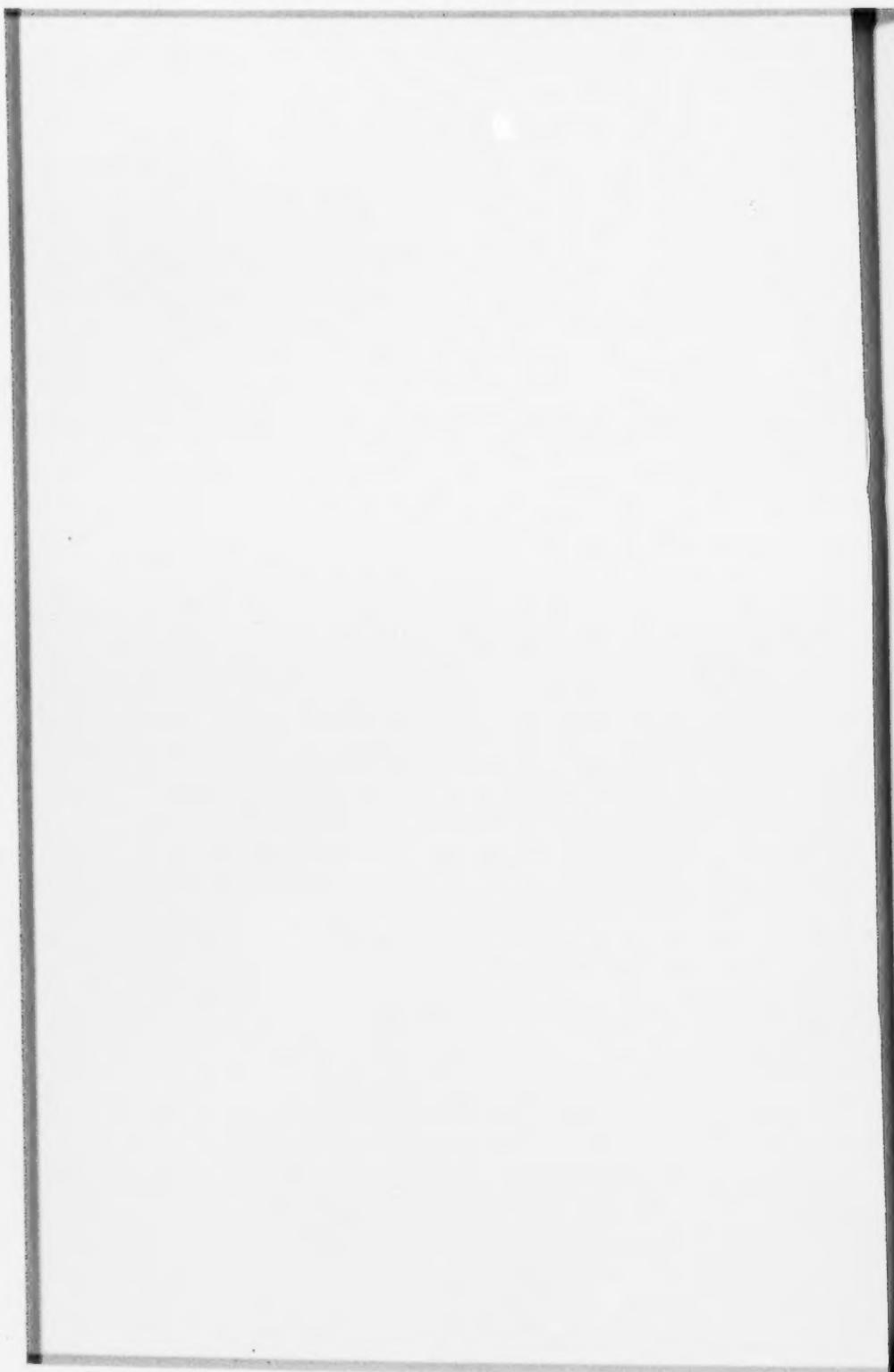
*Counsel for Petitioner.*

DAVIS, PANTZER, BALTZELL & SPARKS,

Indianapolis, Indiana,

*Of Counsel.*





IN THE  
SUPREME COURT OF THE UNITED STATES  
OCTOBER TERM, 1939

No. .....

THE UNION TRUST COMPANY OF INDIANAPOLIS,  
as Former Executor of the Last Will and Testament  
of William H. Block, Deceased,

*Petitioner and Appellant, below,*

v.

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent and Appellee, below.*

BRIEF IN SUPPORT OF PETITION FOR  
WRIT OF CERTIORARI.

I.

THE OPINION OF THE COURT BELOW.

The opinion of the United States Circuit Court of Appeals for the Seventh Circuit is found in the Record, pages 110 to 114, and is reported in ..... Fed. (2d) ..... The opinion of the Board of Tax Appeals is found in the Record, pages 89 to 94, and is reported in 39 B. T. A. 338.

II.

JURISDICTION TO REVIEW THE JUDGMENT.

This Court has jurisdiction to review by virtue of Internal Revenue Code, Section 1141 (a), 26 U. S. C. A., Section 1141 (a) and Section 240 (a) of the Judicial Code, as amended. (28 U. S. C. A. s. 347, (a)). The annexed

petition, this brief, and the record have been filed within the time prescribed by the Act of February 13, 1925, c. 229, s. 8, 43 Stat. 940, 28 U. S. C. A. s. 350, since the judgment of the Circuit Court of Appeals for the Seventh Circuit was entered February 27, 1940, (R. 115). No petition for a rehearing was filed.

### III.

#### STATEMENT OF THE CASE.

##### *First. The Taxability of the Estate Tax Refund*

Petitioner's testator died December 11, 1928. (R. 19.) Federal estate tax, aggregating, with interest, \$829,292.39, was paid as follows:

Dec. 11, 1929,	\$564,299.23
July 1, 1930,	16,141.39
Jan. 15, 1931,	248,851.77.

(R. 20.)

Pursuant to Section 301(b) of the Revenue Act of 1926, petitioner deducted these amounts in computing taxable net income for these years, in returns filed March 15, 1930, March 14, 1931, and March 15, 1932.

By law effective March 6, 1931, the State of Indiana imposed a retroactive estate tax upon this estate, measured by 80% of the Federal Tax. (The obvious purpose and effect of this law was to divert to the State of Indiana the 80% credit for state tax allowed by Section 301 (b) of the Revenue Act of 1926. (Acts Ind. 1931, Ch. 75, Section 38, p. 217, Burns' Ind. Stat., 1933, section 6-2438).

The incidence of the new Indiana tax and the Federal tax refund consequent thereon were both known to the

Revenue Agent in charge of the Indianapolis office not later than December 31, 1931, when petitioner's 19~~29~~<sup>31</sup> income tax return was audited. (R. 69-70.) At this time the two year limitation (Revenue Act 1928, Section 275) upon redetermination of petitioner's 1929 tax liability had not expired by two and one-half months. The return was marked "Closed 1-22-32" although the audit report, in referring to the impending payment of the additional tax, stated that "a refund will be given taxpayer which will be paid to the State of Indiana and may be deducted as an extra deduction without including such refund as income." (R. 70.)

Audit of the estate's income tax return for the year 1930 was completed August 20, 1932, and its acceptance recommended (R. 73). Audit of the estate income tax return for 1931 was completed November 8, 1933, and its acceptance recommended (R. 84).

On June 16, 1932, the additional tax so levied by the State of Indiana in the amount of \$611,228.58 was paid to the State of Indiana from funds borrowed by the executor from The William H. Block Company. The refund of Federal estate tax consequent upon payment of such additional tax to the State of Indiana, consisting of an overpayment of \$603,983.25, and interest in the amount of \$47,836.36, was received by petitioner October 12, 1932 (R. 21, 53). In rendering return of income for the calendar year 1932, petitioner included as income the interest received upon such refund, but did not include the principal amount of the refund (R. 57).

*Second. The Deductibility of Income Paid to Beneficiaries.*

By the will of William H. Block, substantially all of his property was bequeathed to trustees to be held for twenty

years after his decease, with direction to pay *from the income a stipulated annual sum* to his wife, stipulated annual sums to certain other persons, and, subject to these prior payments, *to pay the remainder of the net income* to three sons (R. 24, 25). The pertinent provisions of the will directing these payments are as follows:

“ITEM III (A). After paying the taxes, and other proper expenses of the administration of said trust, my trustees *shall pay from the net income* thereof to my wife, Amelia Block, while she lives, \$50,000.00 per year \* \* \* subject to prior payments of the annuities hereafter charged, the *remainder of the net income* of said trust estate shall be paid to my three (3) sons. \* \* \* (R. 25).

“ITEM III (D). I direct that the following *annuities be paid from the income of said trust fund* while said trust continues, and charge the payment thereof, *upon the termination of said trust*, against that portion of the principal thereof, not given to my wife, remaining in the hands of the Trustees for final distribution, *viz.:*” (Here follow specified amounts to be paid to the persons named in Item III (D), said persons being decedent’s sister, his sons Harry and William H., Jr., his daughters-in-law and his grandchildren.) (R. 27.) (Italics ours.)

The payments from income thus directed to be made to the sister, sons, daughters-in-law and grandchildren, are the ones whose deductibility is in question.

Prior to the inception of the trust, these payments were directed to be made by the executor as follows:

“All payments hereinbefore directed to be made from the income of my residuary estate, shall be made in monthly installments, unless expressly otherwise provided, and except the payments of residuary income to my sons, Meier, Rudolph and

Edward, shall begin within one month following my death. Prior to the time such residuary estate is turned over to my Trustees, such payments shall be made by my Executor, and in case at any time, either before or after said residuary estate comes into the hands of said Trustees, there shall not be sufficient income to make such payments, such deficiency shall be made up by pledging a part of the corpus of my estate; such pledge to be discharged from future income, as and when income in sufficient amounts is realized." (R. 31.)

Distribution of the principal of the corpus of the estate was directed to be made in four parcels, respectively at six, twelve, sixteen and twenty years from the testator's death. (R. 26.)

In addition to the above quoted provision of Item III (F) (1) of the Will, continuance of the payments theretofore directed to be made from income upon final distribution of the corpus is directed in the folowing language:

"E. Prior to final distribution of the principal of the general trust hereinbefore created, there shall be paid to The Union Trust Company of Indianapolis, Trustee, to be held in trust by it as herein-after provided, sufficient money to create each of the special trust funds hereinafter set out, the payment of which moneys is hereby charged against the principal of said general trust fund remaining in the hands of my Trustees immediately prior to the final distribution thereof, and the necessary funds, if not paid by the distributees of such general trust, shall be realized from such undistributed principal." (R. 29.)

Such section further provides that only income from such special trust funds shall be paid to the beneficiaries. (R. 29, 30.)

In rendering the estate's income tax return for the calendar year 1932, the executor, assuming to act under the authority of Sections 162 (b) and (c) of the Revenue Act of 1932 (U. S. C. A., Title 26, Sec. 162), deducted from the income there reported a total of \$105,583.34 paid from the income of the estate to the beneficiaries of Item III (D) (1), (2), (3), (4) and (5) (R. 58, 59.)

#### STATUTES INVOLVED.

##### Section 301(b) of the Revenue Act of 1926:

“(b) The tax imposed by this section shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or Territory or the District of Columbia, in respect of any property included in the gross estate. The credit allowed by this subdivision shall not exceed 80 per centum of the tax imposed by this section, \* \* \* \*”

##### Section 275(a) of the Revenue Act of 1928:

“(a) *General Rule.* The amount of income taxes imposed by this title shall be assessed within two years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.”

##### Section 22(b)(3) of the Revenue Act of 1932:

“(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

\* \* \* \*

(3) *Gifts, Bequests, and DeVises.*—The value of property acquired by gift, bequest, devise, or in-

heritance (but the income from such property shall be included in gross income);"

Section 162(b) of the Revenue Act of 1932:

"The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—\* \* \* \*

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, \* \* \* but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not."

Section 38 of Chapter 75 of the Acts of Indiana 1931:

"See. 38. An additional inheritance tax shall be and is hereby imposed upon all estates which are subject to an estate tax under the provisions of the United States revenue act of nineteen hundred and twenty-six where the decedent at the time of his decease was a resident of this state. The amount of said tax shall be the amount by which eighty per cent of the estate tax imposed by the United States government under the provisions of said revenue act of nineteen hundred and twenty-six exceeds the aggregate amount of all estate, inheritance, legacy, transfer and succession taxes actually paid to the several states of the United States or the District of Columbia, in respect to any property in the estate, inheritance, estate or legacy of said decedent. The provisions of this section shall apply to estates of decedents dying on or after the effective date of the revenue act of 1926: *Provided, however,* That in the event the United States government should refuse to allow a credit or should collect the amount of the credit previously allowed by it for the additional

inheritance tax imposed by sections 38 and 39 of this act, then the treasurer of state, on order of the auditor of state, approved by the state board of tax commissioners, shall without legislative appropriation therefor refund and pay over the tax imposed by said sections and paid to the State of Indiana by the estate of any person dying after the effective date of the revenue act of 1926 and before the date this act becomes effective, to the estate or person or persons paying such tax, together with interest at the rate of six per cent per annum from the date of refund thereof; \* \* \*

#### SUMMARY OF ARGUMENT.

##### *One.*

The refund of federal estate tax received by petitioner in 1932 did not, without more, constitute income of such year within the meaning of the Sixteenth Amendment and Section 22(a) of the Revenue Act of 1932.

##### *Two.*

The deduction of the refunded tax in computing petitioner's taxable net income for the years 1929, 1930 and 1931 does not estop petitioner to deny taxability of the refund of such tax received in 1932; since the probability of such refund was known in ample time to have redetermined petitioner's tax liability for all such prior years, and when such refund was actually paid and received there remained five months to redetermine petitioner's tax liability for 1930, and seventeen months for 1932.

(Elimination of the tax liability on refund of the tax paid in 1931 would extinguish liability on the 1932 return.)

*Three.*

Income paid to beneficiaries annually, pursuant to testamentary direction to pay income, was properly deductible from petitioner's taxable income and taxable to beneficiaries under Revenue Act 1932, Section 162(b), and did not constitute an exempt bequest under Section 22(b) (3), notwithstanding further provisions for supplying deficiencies of income by pledge of the corpus to be discharged from future income, since payment otherwise than from income was directed by separate provision of the will, and was not certain to happen in the event of a deficiency of income, but depended both on possibility of securing a willing lender and upon a reasonable probability that future income would suffice to discharge the loan.

## ARGUMENT.

Petitioner's testator died December 11, 1928. (R. 19.) Federal estate tax against his estate was determined and paid (with interest), in three instalments, one in each of the years 1929, 1930, and 1931. The last payment in the amount of \$248,851.77 was made January 15, 1931. (R. 20.) Pursuant to the express provision of the law then in force (Revenue Act 1928, Section 23, e.) petitioner deducted these payments from taxable income in petitioner's income tax returns for these years, which were respectively filed on March 15, 1930, March 14, 1931, and March 15, 1932.

March 6, 1931, the legislature of Indiana imposed upon all estates subject to tax under "the United States revenue act of nineteen hundred and twenty-six" (which included this estate) an additional tax in "the amount by which 80% of the estate tax imposed by the United States Government" exceeded taxes paid to the several states or the district of Columbia. (Indiana Acts 1931, Ch. 75, Sec. 38 p. 217, Burns Ind. Stat. 1933, Sec. 6-2438.) The obvious purpose and effect of this retroactive tax was to divert to the State of Indiana the amount of the 80% credit for state taxes allowed by Section 301(b) of the Revenue Act of 1926, 26 U. S. C. A., Section 301(b).

That petitioner would be assessed this additional state tax, and that as a consequence a large amount of federal estate tax previously paid would be refunded, was known to the Revenue Agent who audited petitioner's income tax return for the year 1929 at least as early as December 31, 1932. In his report of such audit he called attention to the additional credit against federal estate tax to which petitioner would become entitled upon payment of the additional Indiana tax, and stated "That a refund will be given

taxpayer which will be paid to the State of Indiana and may be deducted as an extra deduction without including such refund as income." (R. 70.) Notwithstanding the report specifically directing attention to the fact that at least a portion of the tax deduction taken in this return was erroneous, the return was stamped "Closed 1-22-32." (R. 64.) *On the last named date, almost two months remained of the then two years limitation upon redetermination of petitioner's liability for the year 1929.*

The additional Indiana tax in the amount of \$611,228.58 was actually paid June 16, 1932. (R. 21.) The refund of federal estate tax consequent upon this was paid to petitioner October 12, 1932. (R. 21, 53.) *On the date of this refund there remained over five months to redetermine petitioner's income tax liability for 1930 and over one year and five months to redetermine the tax liability for 1931.* In these latter years deductions of \$16,268.17 and \$248,-851.77 had been taken for federal estate tax. (R. 75, 79.)

It is settled by decisions of this Court that only "income" may constitutionally be taxed by Congress under the Sixteenth Amendment. *Eisner v. Macomber*, 252 U. S. 189.

Apart from some equitable estoppel arising out of the prior deduction of the refunded tax from taxable income, it would seem reasonably clear that a refund of estate tax does not constitute "income" to the estate as the term income has been defined by decisions of this Court. *Bowers v. Kerbaugh-Empire Co.*, 271 U. S. 170, contains the following definition, supported by ample citation:

"After full consideration, this Court declared that income may be defined as gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of

capital. *Stratton's Independence v. Howbert*, 231 U. S. 399, 415; *Doyle v. Mitchell Brothers Co.*, 247 U. S. 179, 185; *Eisner v. Macomber*, 252 U. S. 189, 207. And that definition has been adhered to and applied repeatedly. See e. g. *Merchants L. & T. Co. v. Smietanka*, *supra*, 518; *Goodrich v. Edwards*, 255 U. S. 527, 535; *United States v. Phellis*, 257 U. S. 156, 169; *Miles v. Safe Deposit Co.*, 259 U. S. 247, 252-253; *United States v. Supplee-Biddle Co.*, 265 U. S. 189, 194; *Irwin v. Gavit*, 268 U. S. 161, 167; *Edwards v. Cuba Railroad*, 268 U. S. 628, 633."

The estate tax was not paid as incident to the conduct of any business engaged in for profit. Its refund was not the recovery of any expenditure previously made for the sake of profit. Its refund was not a gain resulting from the employment of capital, or labor, either or both. In short, this refund does not answer any part of the definition of income given in the case last cited.

There are various examples of the exclusion from "income" of receipts not falling within the definition. Thus alimony (*Jane B. Coates*, 3 B. T. A. 429), damages for personal injury (*T. P. Riddle*, 27 B. T. A. 1339), and damages for injury to good will (*Farmers & Merchants Bank v. Commissioner*, (C. C. A. 6th, 1932), 59 F. (2d) 912), have been held not to constitute income.

*Burnett v. Sanford and Brooks Company*, 282 U. S. 359, involving taxability of damages received for breach of contract, which was strongly relied upon by the Circuit Court of Appeals, is, we submit, distinguishable. The Court said:

"The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equalled, and in a loose sense was a return of, expenditures

made in performing the contract, still, as the Board of Tax Appeals found, the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income."

In other words, the damages received restored expenditures which had been made to earn income, expenditures which had operated to reduce income. The damages, in effect, constituted deferred income.

It is to be noted that the Court was careful to point out that the damages were not in restoration of a capital investment but were taxable solely because they were the restoration of expenses incurred "for the purpose of earning profits." That the Federal Estate tax paid was a capital levy, not an expense of earning income, and that its restoration constitutes a restoration of capital is no better illustrated than by the fact that the right to deduct such expenditures from estate income tax returns was withdrawn by the Revenue Act of 1934. (Revenue Act of 1934, Section 23(c).) The reason for withdrawing the allowance of such deduction is stated by the House Committee on Ways and Means on page 22 of Report No. 704 to the Revenue Bill of 1934 as follows:

"Paragraph (c) of the bill denies the deduction allowed under existing law for estate, inheritance, legacy, succession, and gift taxes. These taxes constitute expenses which are not incurred in the production of income, and liability for them attaches regardless of whether there is any income. *They constitute, in fact, mere charges imposed upon the transfer of capital.*" (Italics ours.)

Other cases relied upon by the Court are also distinguishable.

*Commissioner v. Liberty Bank and Trust Company*, (C. C. A. 6th, 1932), 59 F. (2d) 320, is a case involving taxability of bad debts recovered after having been deducted from taxable income of prior years. The decision goes not only upon the ground of estoppel arising from the taxpayer's previous claim of deduction, but also upon express provision of the regulations which, at least since 1916, have always required as a condition of deductibility that bad debts deducted from income and subsequently recovered shall be returned as income in the year of recovery.

*Nash v. Commissioner*, (C. C. A. 7th, 1937), 88 F. (2d) 477, is likewise a case of estoppel to be more fully discussed hereafter.

It is submitted, therefore, that unless an estoppel arise from the fact that the refunded tax had been used to reduce petitioner's taxable income for the years 1929, 1930 and 1931, it was error to include this refund in computing petitioner's taxable income for the year 1932.

We submit that under the facts of this case no such estoppel exists. Under the Indiana law as it existed when the federal estate tax was paid, the amount of the federal estate tax had been properly determined, and by the express provision of the Revenue Act then in force payments of federal estate tax were properly deductible in computing petitioner's net income. The retroactive Indiana estate tax of 1931 operated to give to petitioner an additional credit which reduced the amount payable to the United States resulting in petitioner's right to a refund of federal estate tax. At the same time and as a result of

the same law, the deductions previously taken from petitioner's income tax returns for the years 1929, 1930 and 1931 became improper. The United States had a right, and the Commissioner had a duty, to redetermine and reassess petitioner's income tax liability for these years. That the Commissioner's failure so to do was not the result of ignorance of fact on his part or of any misrepresentation or default on the part of the taxpayer, clearly appears from the record. In auditing the return for 1929, more than two months before the statute of limitations had barred its reassessment and correction, the Revenue Agent in charge of the Indianapolis office advised the Department of the impending refund to which the petitioner would become entitled. (R. 69, 70.) Notwithstanding this clear warning, the return was marked closed on the 22nd of January, 1932, when there still remained fifty-three days during which the deduction taken might have been disallowed and the income tax liability for 1929 redetermined.

With respect to the returns for the years 1930 and 1931 the Commissioner's knowledge of the facts and timely opportunity to make a reassessment is even clearer. The refund was actually paid to petitioner on October 12, 1932, and limitations did not run on the 1930 return for more than five months thereafter and did not run on the 1931 return until a year and five months thereafter. In these facts, we submit lies a vital difference between this case and the case of *Nash v. Commissioner*, (C. C. A. 7th, 1937), 88 F. (2d) 477, the other authority relied upon by the Circuit Court of Appeals. Here the tax was refunded by the United States, and the Commissioner had full knowledge thereof. In the *Nash* case the refund was made by the State of Wisconsin, and it does not appear that the Commissioner of Internal Revenue had any knowledge of facts

authorizing redetermination of the prior years' taxes until after limitations had run thereon.

Under these circumstances, to permit the entire refund to be charged to petitioner as income in the year received merely because it represented the restoration of amounts which, by reason of subsequent change in the law, had been erroneously deducted from the income of prior years, gives to the Commissioner the wholly arbitrary power of selecting the year or years in which taxable income may be augmented. That the taxpayer may not make such an arbitrary election was decided in *Inland Products Company v. Blair* (C. C. A. 4th, 1929), 31 F. (2d) 867. In that case the taxpayer had paid and deducted from taxable income in the years 1919 and 1920 certain state excise taxes which were subsequently determined to have been erroneously assessed and were refunded to him in 1925. The Commissioner in that case elected to reassess petitioner's liability for the years 1919 and 1920 against the contention of the taxpayer, who preferred to treat the refund as income for the year 1925.

In the case last cited the contention of the Commissioner was upheld, and we submit that there is, therefore, a clear conflict between the decision of the Circuit Court of Appeals for the Fourth Circuit in *Inland Products Co. v. Blair* and the decision of the Circuit Court of Appeals for the Seventh Circuit in the instant case.

That the Circuit Court of Appeals relied very strongly on some supposed estoppel growing out of the "wrongful deductions" of prior years, is clearly evidenced by the following quotation from the opinion:

"Thus it is apparent, without the wrongful deduction because of Federal estate tax, that peti-

tioner, for that year, would have been liable for a substantial income tax, but by employing this wrongful deduction, a saving was thereby effected. In fact, by reason of this deduction there was no net income and no tax paid. Petitioner also was enabled, by these wrongful deductions for the years 1930 and 1931, to escape the payment of an income tax for which it otherwise would have been liable. It now is too late to revise the returns for those years and to require the petitioner to pay the tax which would have been required of it except for the wrongful deductions.

Respondent acknowledged the wrongful collection of the Federal estate tax, but petitioner, when made whole in the form of a refund, after having utilized such payments as deductions, with the resultant saving to the estate, takes the position that such refund should not be included in its gross income. The Board decided to the contrary and, we think properly so." (R. 112.)

Since the erroneous nature of these prior deductions was discovered in ample time to have redetermined petitioner's liability for those years, and since the Commissioner's failure so to do resulted from no fault or neglect on the part of petitioner, it is submitted that no such estoppel arises. It seems irrelevant to say that "it is *now* too late" to revise the earlier returns. The pertinent inquiry is, was it too late when the mistake was discovered? To hold that, under these circumstances, the petitioner is estopped to question the inclusion in its 1932 return of the otherwise non-taxable item of estate tax refund is, we submit, squarely contrary to the principle of the decision of this Court in *McEachern v. Rose*, 302 U. S. 56. In that case the taxpayer had erroneously reported as taxable in the years 1928 to 1931, inclusive, certain transactions which had in fact been taxable in the year

1928 and were not taxable in the years in which reported. The Commissioner's contention was that since the unpaid tax for the year 1928 would have been greater in amount than the erroneous tax for which recovery was sought, the taxpayer was equitably estopped from recovering.

It will be noted that in the above case the taxpayer had not only erroneously failed to make a proper return for the year 1928, but also his alone was the error responsible for the improper returns upon which he sought to recover. It was nevertheless held that express provisions of the Revenue Act prevented the Government from taking any benefit from the over-paid tax by crediting it against an unpaid tax, the collection of which had been barred by limitations. Here the Government seeks to recoup taxes of prior years by assessing as income of a subsequent year that which is not otherwise income, merely because reassessment of the prior years is barred by limitation. We submit that this should not be permitted, where the mistake was known in time to have assessed the tax for the proper years. To permit it would, in effect, allow the Commissioner to ignore the time limitation contained in the law, and to permit the Government to recoup for the year 1932 that to which it was entitled, if at all, only for the years 1929, 1930, and 1931.

A further equitable consideration bearing upon this alleged estoppel deserves mention. The refund of Federal tax in the year 1932 did not, in fact, augment the estate one iota. The refund was granted solely because an additional tax of the same amount was payable to the State of Indiana and the ultimate liability to the State of Indiana was expressly conditioned upon the Federal refunds being granted. The Indiana Act of 1931 provided that in the event that the United States should refuse to allow the

credit, the additional tax imposed by the State should be refunded. Consequently, the substance of the whole transaction was that the petitioner was simply made a conduit to divert the amount of this refund from the coffers of the United States to the coffers of the State of Indiana, and yet the effect of the rulings of the Commissioner of Internal Revenue, the Board of Tax Appeals, and the Circuit Court of Appeals of the Seventh Circuit is to charge the petitioner for the privilege of so acting as though petitioner had actually enjoyed a gain of over \$600,000.00. We submit that no equitable estoppel can be founded upon such inequity.

#### CLAIMED DEDUCTION OF INCOME PAID TO BENEFICIARIES.

Section 22(b)(3) of the Revenue Act of 1932 excludes from taxable income "the value of property acquired by gift, bequest, devise or inheritance (but the income from such property shall be included in gross income)."

Section 162(b) of the same Act with reference to computing the net income of estates or trusts provides:

"There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries \* \* \* but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries."

*Irwin v. Gavit*, 268 U. S. 161, held that a bequest of income was taxable to a beneficiary and not exempt under the provisions of the Act of 1913, substantially the same

as the provisions of the Act of 1932 above quoted. The Court said:

“\* \* \* we think that the provision of the Act that exempts bequests assumes the gift of the corpus and contrasts it with the income arising from it, but was not intended to exempt income, properly so called, simply because of the severance between it and the principal fund.” (Page 167.)

*Burnet v. Whitehouse*, 283 U. S. 148, involved a bequest in the following language:

“I also give and bequeath to the said Sybil Douglas, wife of William Whitehouse, an annuity of five thousand dollars.”

This annuity was not directed to be paid from income but was expressly charged against the corpus of the estate with power in the executors to sell corpus to provide for the payment of this and other similar bequests. While the greater part of the annuity had in fact been paid from income, the Court held that it was not a gift of income and was therefore exempt from income tax in the hands of the beneficiary, distinguishing *Irwin v. Gavit* in the following language:

“*Irwin v. Gavit* is not applicable. The bequest to Gavit was to be paid out of income from a definite fund. If that yielded nothing he got nothing. This Court concluded that the gift was of money to be derived from income and to be paid and received as income by the donee. Here the gift did not depend upon income but was a charge upon the whole estate during the life of the legatee to be satisfied like any ordinary bequest.” (Page 151.)

*In Helvering v. Pardee*, 290 U. S. 365, 370, the gift was in the following language:

“I also give unto my said wife an annuity of Fifty Thousand Dollars (\$50,000), to be computed from the date of my decease and to be paid in advance in quarterly payments.”

While it appears from the opinion of the Court that payment to the widow was primarily charged against income, it was also a charge upon the estate as a whole and was payable without regard to income received by the fiduciary. As appears from the opinion of the Board of Tax Appeals, (*Pardee v. Commissioner*, 23 B. T. A. 846), there was *first an outright gift* of the annuity and *subsequently* a direction to pay the same from income.

The decision of the Court, and its reason, is found in the following language:

“The charge was upon the estate as a whole; her claim was payable without regard to income received by the fiduciary. Payments to her were not distribution of income; but in discharge of a gift or legacy. The principle applied in *Burnet v. Whitehouse*, 283 U. S. 148, is applicable.” (Pages 370-371.)

Under the will of William H. Block the only direct gift to the beneficiaries in question is a gift of income. (R. 27.) It is supplemented by a further direction whereby, in the event of a temporary deficiency, future income may be anticipated by borrowing; but this is far from being a gift payable “at all events” without regard to income received by the fiduciary.

It would, we submit, do great violence to the terms of the power to pledge if construed to permit the executor or

trustees to make a pledge "to be discharged from future income" (R. 31) at a time when there was no reasonable probability of realizing future income in sufficient amounts. There is no power to use corpus or to sell it for the purpose of discharging these annuities. The beneficiaries' right to receive *borrowed* money is therefore conditioned upon two uncertainties; one, the possibility of finding a willing lender; two, the reasonable probability, existing coincidentally with a deficiency in current income, that future income will suffice to pay annuities and discharge the pledge. Further, corpus will be invaded by such a pledge only if this reasonable probability fails to become actuality.

We submit, therefore, that the annual sums due to income beneficiaries in the year 1932 and paid from income in that year were properly deductible as "income of the estate \* \* \* distributed currently to beneficiaries" under Section 162(b). (Possibly \$60,000 of the claimed deduction of \$105,583.34 (R. 57) does not qualify, since it represented deferred payments to one beneficiary, William H. Block Jr., R. 59.)

There is a further distinction between *Burnet v. Whitehouse*, 283 U. S. 148, and the case at bar. Here there are in effect two gifts, an unconditional bequest of income, supplemented by a further gift of borrowed money in the event of a deficiency of income.

So long as there is no deficiency of income, the beneficiary takes under the gift of income, and the payments answer exactly the terms of the authorized deduction of Section 162(b). Only when the income is deficient does the second and supplementary gift become operative. Accordingly, the application of 162(b) or of 22(b)(3) never depends upon the arbitrary choice of the executor or trustee,

a circumstance strongly relied upon in *Burnet v. Whitehouse*, 283 U. S. 148, 151.

To the extent that the above does not serve to distinguish *Helvering v. Pardee*, 290 U. S. 365, 370, we submit that the latter case should be re-examined in the light of the dissenting opinion of the Chief Justice, 290 U. S. 371. Surely the intent of Congress to exempt absolute bequests in the hands of the beneficiary should not be used to render a fiduciary taxable on receipts which by Section 162(b) are exempt, merely because the gift of income to the beneficiary is supplemented by conditional provisions, short of an outright gift of corpus, which have never become operative.

Petitioner therefore prays that a writ of certiorari issue, that the opinion and decision of the Circuit Court of Appeals for the Seventh Circuit be re-examined in this Court and that the judgment of such Court and of the Board of Tax Appeals be reversed.

Respectfully submitted,

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IN THE  
**SUPREME COURT OF THE UNITED STATES**

October Term, 1940

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UNION TRUST COMPANY OF INDIANAPOLIS AS  
FORMER EXECUTOR OF THE LAST WILL AND TESTA-  
MENT OF WILLIAM H. BLOCK, DECEASED, PETI-  
TIONER,

No. 105

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR  
THE SEVENTH CIRCUIT

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**PETITIONER'S REPLY BRIEF**

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I.

**THE REFUND OF FEDERAL ESTATE TAX WAS NOT  
TAXABLE INCOME**

It is not contended that a refund of federal estate tax is *per se* income. To make it such, reliance is placed upon

the fact that the amount was deductible in computing *taxable* income of the years in which paid. That, except for Congressional favor, it was not properly an item in the computation of net income, is evidenced by the fact that such deductions are no longer allowable, on the ground that estate tax is a capital levy having no relation to the earning of income. (House Committee on Ways and Means, Report No. 704, Revenue Bill of 1934, page 22.)

That every restoration of a prior expenditure is not "income" is recognized in cases cited by the Respondent. Thus, in *Wichita State Bank & T. Co. v. Commissioner*, 69 F. (2d) 595 (C. C. A. 5th), certiorari denied 293 U. S. 562, the bank was taxed upon the partial restoration of assessments to defray current losses chargeable to a state deposit guaranty fund, but not upon restoration of its contributions to the permanent fund.

The former was restoration of an expense of doing business to earn income. The latter was a restoration of capital.

In *Cooper v. United States*, 9 F. (2d) 216, 224, (C. C. A. 8th), the Court recognized that insurance replacing a previous inventory loss was not "income" in the strict sense, but was taxable because the inventory loss had previously entered into computation of profits and its restoration likewise should enter into a determination of "excess profits."

In *Houbigant, Inc. v. Commissioner*, 31 B. T. A. 954, affirmed 80 F. (2d) 1012 (C. C. A. 2d), certiorari denied 298 U. S. 669, *Commissioner v. Central United National Bank*, 99 F. (2d) 568 (C. C. A. 6th), and *Victoria Paper*

*Mills Co. v. Commissioner*, 32 B. T. A. 666, affirmed 83 F. (2d) 1022 (C. C. A. 2d) the taxes refunded, and in *Automobile Ins. Co. v. Commissioner*, 72 F. (2d) 265 (C. C. A. 2d), the insurance payments restored, represented restoration of prior business expenses, attendant upon the earning of income in prior years, and, as in *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, could properly be classified as deferred income.

Similarly, the property loss restored in *Marine Transport Co. v. Commissioner*, 77 F. (2d) 177 (C. C. A. 5th), had resulted from a risk attendant upon the enterprise (sinking of ship while on voyage) and had been a deductible business expense of earning income.

In *Universal, Inc. v. Commissioner*, 109 F. (2d) 616 (C. C. A. 7th), the refunded excise taxes collected from customers and paid to the United States, without ever having entered into the taxpayer's returns, obviously were business receipts and were a clear business gain when restored at a time when all obligation to refund to the customers had ceased.

The bad debt cases, *Askin & Marine Co. v. Commissioner*, 66 F. (2d) 776 (C. C. A. 2d), *Commissioner v. Liberty Bank & Trust Co.*, 59 F. (2d) 320 (C. A. A. 6th), and *Carr v. Commissioner*, 28 F. (2d) 551 (C. C. A. 5th), are also clearly distinguishable from the instant case, in that it has always been a condition of deductibility that any recovery should be returned as income when received. This is the major ground of decision in *Commissioner v. Liberty Bank & Trust Co.*, 59 F. (2d) 320, 325. No such condition attached to deduction of the tax payments now in question.

It is therefore submitted that a refund of federal estate tax cannot be taxed as income except on the basis of an equitable estoppel arising from its prior deduction from taxable income, and that in this case the facts do not support such an estoppel.

Respondent attempts to harmonize the cases of *Inland Products Co. v. Blair*, 31 F. (2d) 867 (C. C. A. 4th) and *Leach v. Commissioner*, 50 F. (2d) 371 (C. C. A. 1st) upon the theory that in those cases prior years were still open. Respondent's brief (p. 8) stresses the fact that here assessments for 1930 and 1931 were barred "before the petition in the present case was filed with the Board."

Since there was no right or opportunity to file "the petition in the present case" until the Commissioner served notice of deficiency, this argument in effect asserts that the taxpayer is estopped by the Commissioner's own delay in assessing the alleged deficiency in controversy. The deficiency notice giving rise to the "petition in the present case," was not served until March 13, 1935, when limitations had run on all prior years in controversy. (R., 3, 13.) It was the neglect of the Commissioner, after full knowledge, which resulted in limitations having run "before the petition in the present case was filed with the Board." Respondent thus seeks to found an estoppel against petitioner upon his own delay and laches.

The taxpayer was under no legal duty to file amended returns, and we submit that under the circumstances here presented there was no moral duty. The audit of the 1929 return not only disclosed all circumstances, but called specific attention to the (supposed) fact that the taxpayer

would not be required to include the refund as income when received. (R., 69-70.) There was certainly more reason to believe that whatever adjustment was required in the 1929, 1930, and 1931 returns would be made in time than that a deficiency, then disclaimed, would be asserted for 1932.

To recognize an estoppel under such circumstances has the effect of giving to the Commissioner of Internal Revenue an election as to what years shall be made to bear the burden of adjustments consequent upon subsequent alteration of a taxpayer's accounts. We submit that the matter is one to be settled by rules of law and not arbitrary administrative fiat. Liability on account of deductions proved improper by subsequent unforeseen circumstances should not be imposed in either of two years at the whim of the Commissioner.

## II.

### THE DEDUCTIBILITY OF INCOME PAYMENTS TO BENEFICIARIES

Respondent has fairly stated the decisions in *Burnet v. Whitehouse*, 283 U. S. 148, and *Helvering v. Butterworth*, 290 U. S. 365, but has not, we submit, correctly applied them to the instant case. It is stated that:

“Under this testamentary scheme, it is clear that the annuities were not dependent upon the realization of income, but were payable in any event and, if necessary, the payments were to be a charge upon the corpus.”

This, we submit, is inaccurate. Absent income, the annuities were not payable in "any event," but only in the events that (a) a willing lender (not purchaser) could be found, and that (b) there appeared such a reasonable prospect of future income sufficient to discharge the loan that the fiduciaries would be justified in exercising a power to make loans which prescribed this method of discharge. This is far from being an annuity payable at *all events*.

We do not contend that the direction to discharge loans from future income makes the conditional bequest of borrowed money payable from income. We do contend that such a direction limits the power to borrow as well as the probability of its effective exercise in such manner as to negative the construction that the annuities are payable at *all events and from corpus*.

The case of *Duncan v. Commissioner*, 34 B. T. A. 999, affirmed 91 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 302 U. S. 752, relied upon by Respondent, is not in point or even controlling, since in default of income the gifts were absolutely payable from corpus (not from funds whose availability depended on finding a lender), and the direction to restore corpus from income did not in any manner limit the absolute power and duty to pay from corpus. Here, we submit, the trustees are not authorized to borrow unless a reasonable probability of sufficient future income is apparent.

Here, there are in effect two gifts, an absolute gift of income, and a conditional gift of borrowed funds. The condition of the second gift has never happened and it

should not, therefore, affect the incidence of tax with respect to the first gift.

Respectfully submitted,

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# In the Supreme Court of the United States

OCTOBER TERM, 1940

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No. 105

UNION TRUST COMPANY OF INDIANAPOLIS AS FORMER  
EXECUTOR OF THE LAST WILL AND TESTAMENT OF  
WILLIAM H. BLOCK, DECEASED, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH  
CIRCUIT*

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**BRIEF FOR THE RESPONDENT IN OPPOSITION**

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## OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 88-94) is reported in 39 B. T. A. 338. The opinion of the Circuit Court of Appeals (R. 110-114) is reported in 111 F. (2d) 60.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 27, 1940. (R. 115.) The petition for a writ of certiorari was filed on May 27, 1940. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

**QUESTIONS PRESENTED**

1. Whether an estate is subject to income tax for the year 1932 on a refund of federal estate taxes received during that year, when the taxes refunded had been claimed and allowed as a deduction from the gross income of the estate for 1929, 1930, and 1931, the years in which the estate taxes were paid.

2. Whether amounts payable annually to beneficiaries of a testamentary trust are allowable deductions from the gross income of the estate, where the payments do not depend exclusively upon trust income.

**STATUTE INVOLVED**

Revenue Act of 1932, c. 209, 47 Stat. 169:

**SEC. 22. GROSS INCOME.**

(a) **GENERAL DEFINITION.**—“Gross income” includes \* \* \* gains or profits and income derived from any source whatever. \* \* \*

(b) **EXCLUSIONS FROM GROSS INCOME.**—The following items shall not be included in gross income and shall be exempt from taxation under this title;

\* \* \* \* \*

(3) **GIFTS, BEQUESTS, AND DEVISES.**—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

\* \* \* \* \*

**SEC. 162. NET INCOME.**

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

\* \* \* \* \*

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, \* \* \*, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. \* \* \*

**STATEMENT**

The pertinent facts, as stipulated (R. 18-23) and as found by the Board of Tax Appeals (R. 89-94), may be summarized as follows:

1. The decedent died on December 11, 1928, a resident of Indiana. The executor of his estate paid federal estate taxes as follows (R. 89):

December 11, 1929-----	\$564,299.23
July 1, 1930-----	14,992.00
January 15, 1931-----	233,859.15

Deductions were claimed by the estate for the above amounts on the income tax returns of the estate for the appropriate years. The deductions were allowed. The statute of limitations has now run against any additional assessments of income tax for those years. (R. 89-90.)

The amount of the tax paid was computed after deducting a credit for the amount of state inheritance tax which was due under the laws of Indiana as they existed prior to March 6, 1931. The laws of Indiana were amended on that day to increase retroactively the state inheritance tax due upon estates, including the estate of this decedent. Pursuant to this amendment, the estate paid, on June 16, 1932, an additional state inheritance tax of \$611,228.58. That amount was claimed and allowed as a deduction from income of the estate for 1932, the year here involved. (R. 90.)

In the meantime, a proceeding was instituted before the Commissioner for redetermination of the federal estate tax because of the increased liability to the State of Indiana. By stipulation before the Board, petitioner was allowed full credit for the additional inheritance tax due the state and, as a result, petitioner received a refund of \$603,983.25 on October 12, 1932. (R. 90.)

The estate kept its books and made its returns upon a cash receipts and disbursements basis. In filing its income tax return for 1932, it did not include in gross income the \$603,983.25 received by way of refund. The Commissioner, in determining the deficiency, included this amount in gross income. (R. 89-90.)

2. The testator in his will directed the trustees to pay \$50,000 per annum from the net income of his estate to his wife, the annual payment to decrease as the estate was distributed. (R. 25.) The tes-

tator also directed (R. 27-28) that several annuities be paid from the income of his estate. With regard to the operation of the estate, Item III, section F, of the will stated (R. 31):

1. All payments hereinbefore directed to be made from the income of my residuary estate, shall be made in monthly installments, unless expressly otherwise provided, and except the payments of residuary income to my sons, Meier, Rudolph and Edward, shall begin within one month following my death. Prior to the time such residuary estate is turned over to my Trustees, such payments shall be made by my Executor, and in case at any time, either before or after said residuary estate comes into the hands of said Trustees, there shall not be sufficient income to make such payments, such deficiency shall be made up by pledging a part of the corpus of my estate; such pledge to be discharged from future income, as and when income in sufficient amounts is realized.

The estate's income tax return for 1932 deducted \$105,583.34, which was the sum of the annuities referred to above. The Commissioner disallowed this deduction. (R. 23.)

3. The Board of Tax Appeals held (1) that the refund received in 1932 was subject to income tax in that year; and (2) that the payments to the beneficiaries were annuities and not distributions of income and, consequently, were not deductible from the income of the estate. Accordingly it de-

terminated that there was a deficiency in income tax for 1932 in the amount of \$49,798.74. (R. 92, 94-95.) The court below affirmed. (R. 115.)

#### ARGUMENT

1. The decision below that the refund of federal estate taxes in 1932 was income taxable to petitioner for that year is clearly correct and accords with settled principles. The refunded taxes were properly paid in 1929, 1930 and 1931 and, consequently, were properly deducted from the income of the estate during those years. Petitioner became entitled to a refund only in 1932, when the increased state inheritance tax was paid. In these circumstances, the refund constituted income when made. *Houbigant, Inc. v. Commissioner*, 31 B. T. A. 954, affirmed, 80 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 298 U. S. 669; *Nash v. Commissioner*, 88 F. (2d) 477 (C. C. A. 7th), certiorari denied, 301 U. S. 700; *Commissioner v. Central United National Bank*, 99 F. (2d) 568 (C. C. A. 6th); *Universal, Inc. v. Commissioner*, 109 F. (2d) 616 (C. C. A. 7th); *Victoria Paper Mills Co. v. Commissioner*, 32 B. T. A. 666, affirmed, 83 F. (2d) 1022 (C. C. A. 2d); cf. *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359; *United States v. White Dental Co.*, 274 U. S. 398, 403; *Helvering v. Midland Mutual Life Insurance Co.*, 300 U. S. 216; *Brown v. Helvering*, 291 U. S. 193; *North American Oil v. Burnet*, 286 U. S. 417, 424.

The same principle has been applied by the Circuit Courts of Appeals in many analogous situations. Thus, debts charged off as worthless constitute income if they are subsequently recovered. *Askin & Marine Co. v. Commissioner*, 66 F. (2d) 776 (C. C. A. 2d); *Putnam Nat. Bank v. Commissioner*, 50 F. (2d) 158 (C. C. A. 5th); *Commissioner v. Liberty Bank & Trust Co.*, 59 F. (2d) 320, 325 (C. C. A. 6th); *Carr v. Commissioner*, 28 F. (2d) 551 (C. C. A. 5th). Assessments paid to a State Depositors' Guaranty Fund originally deducted are treated as income when later returned. *Wichita State Bank & T. Co. v. Commissioner*, 69 F. (2d) 595 (C. C. A. 5th), certiorari denied, 293 U. S. 562. An award by the Mixed Claims Commission on account of property confiscated by Germany is regarded as income, where deductions had been taken in the year of confiscation. *Automobile Ins. Co. v. Commissioner*, 72 F. (2d) 265 (C. C. A. 2d); *Marine Transport Co. v. Commissioner*, 77 F. (2d) 177 (C. C. A. 5th). Cf. *Cooper v. United States*, 9 F. (2d) 216, 223-224 (C. C. A. 8th). A check given for valid obligations when issued, but uncashed at the end of two years and credited to profit and loss, constitutes income. *Chicago R. I. & P. Ry. Co. v. Commissioner*, 47 F. (2d) 990 (C. C. A. 7th), certiorari denied, 284 U. S. 618.

Neither *Inland Products Co. v. Blair*, 31 F. (2d) 867 (C. C. A. 4th), nor *Leach v. Commissioner*, 50 F. (2d) 371 (C. C. A. 1st) is inconsistent with the decision below. In those cases the returns for the

earlier years were still open and before the Commissioner and the courts. See *Chevy Chase Land Co. v. Commissioner*, 34 B. T. A. 150, 153. Consequently, two methods of treating the refund were available: correction of the earlier return or addition to gross income in the later year. The courts in the *Inland Products* and *Leach* cases held that the former method was preferable, since it placed the parties in the position which they would have occupied had there been no mistake of law in the original payment of the tax. But those cases did not hold that that method of treating the refund is the only admissible one. Indeed, the decision in the *Inland Products* case, which was followed in the *Leach* case, was careful to reserve the question as to what the result would be where the statute of limitations had run on the earlier years. In the present case, as distinguished from the *Inland Products* and *Leach* cases, the deductions were correctly computed and allowed in the years claimed; no case involving those years was pending when the refund was received and no additional assessment could have been made for 1929, the year in which most of the estate tax was paid, since the statute of limitations had run before the refund was made. Assessments were also barred for the other years before the petition in the present case was filed with the Board. Whatever might be the result where the earlier years are open, it remains true that under correct accounting and legal prin-

ciples it is permissible to treat the refund as income when received. See cases cited *supra*, p. 6.

It should be noted that the *Inland Products* and *Leach* cases were strongly relied upon in the petitions for certiorari in *Houbigant v. Commissioner*, *supra*, and *Nash v. Commissioner*, *supra*, but in both cases the writ was denied. 298 U. S. 669; 301 U. S. 700. There is no valid distinction between the present case and the *Houbigant* and *Nash* cases.

2. The decision of the court below that the distributions to the beneficiaries under the testamentary trust were payments of annuities and therefore not deductible by the estate is likewise correct and in accordance with the applicable decisions of this Court. An annuity is a bequest payable in any event, and, if necessary, from the corpus. Such an annuity is not taxable to the recipient (*Burnet v. Whitehouse*, 283 U. S. 148), and cannot be deducted by the trustee, even though it is paid out of income. *Helvering v. Butterworth*, 290 U. S. 365, 370-371. And the same rule applies even though provision be made in the will for the restoration of the corpus from later income in the event that any of the corpus is used to pay the annuity. *Duncan v. Commissioner*, 34 B. T. A. 999, affirmed, 91 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 302 U. S. 752.

The present case falls squarely within the principle established by these decisions. The decedent directed that the annuity should be paid out of trust income, but if the income was insufficient the deficiency was to be made up by pledging a part of

the corpus as security for a loan, which was to be repaid from future income (R. 31). Under this testamentary scheme, it is clear that the annuities were not dependent upon the realization of income, but were payable in any event and, if necessary, the payments were to be a charge upon the corpus. In these circumstances, the distributions, even though actually made from income, are not deductible. *Helvering v. Butterworth, supra*; *Boston Safe Deposit & Trust Co. v. Commissioner*, 66 F. (2d) 179 (C. C. A. 1st), certiorari denied, 290 U. S. 700; *Warner v. Commissioner*, 66 F. (2d) 403 (C. C. A. 2d), certiorari denied, 290 U. S. 688.

#### CONCLUSION

The decision below is correct and presents no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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JUNE, 1940.

